VZCZCXRO5414
RR RUEHAST RUEHBI RUEHCI RUEHDBU RUEHLH RUEHNEH RUEHPW
DE RUEHNE #0994/01 1351316
ZNR UUUUU ZZH
R 151316Z MAY 09
FM AMEMBASSY NEW DELHI
TO RUEHC/SECSTATE WASHDC 6609
INFO RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RULSDMK/DEPT OF TRANSPORTATION WASHDC
RHMFIUU/FAA NATIONAL HQ WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHDC

UNCLAS SECTION 01 OF 03 NEW DELHI 000994

SENSITIVE
SIPDIS

STATE FOR SCA/INS AND EEB
USDOC FOR ITA/MAC/OSA/LDROKER/ASTERN/KRUDD
DEPT OF ENERGY FOR A/S KHARBERT, TCUTLER, CZAMUDA, RLUHAR
DEPT PASS TO USTR CLILIENFELD/AADLER/CHINCKLEY
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA MNUGENT
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN
USDA PASS FAS/OCRA/RADLER/BEAN/FERUS
EEB/CIP DAS GROSS, FSAEED, MSELINGER

E.O. 12958: N/A
TAGS: ECON EAGR EAIR ECPS EFIN EINV EMIN ENRG EPET ETRD
BEXP, KBIO, KIPR, KWMN, IN
SUBJECT: INDIA'S NEW PENSION SCHEME AN IMPORTANT FIRST STEP IN
PROVIDING MORE UNIVERSAL COVERAGE

REFTEL A) NEW DELHI 2455 (2008)
B) NEW DELHI 2972 (2008)
C) NEW DELHI 104

¶1. (SBU) Summary: India's Pension Fund Regulatory and Development Authority (PFRDA) opened the "New Pension Scheme" (NPS) to all Indians between the ages of 18-55, including private sector companies, self-employed professionals and informal sector low wage workers, on May 1, 2009. The NPS had previously only been available to government employees. PFRDA has appointed six fund managers, including three from the private sector, and different investment options allow a mix of investment in equities, mutual funds, and bonds. Investors can open their accounts at points of presence provided by 22 service providers permitted by PFRDA, currently banks and financial service firms, but excluding insurance firms. Currently, the NPS attracts a tax at maturity, but subscribers could see NPS payouts made tax free in the first budget of a new government after elections. Minimum contributions and fixed cost charges may limit affordability initially. However, opening the NPS to the informal sector is a critical first step in serving the vast number of Indians working with no retirement support system, estimated at nearly 400 million. Indian demographics that are currently marked by a young population boost the chances of making this a viable long-term support system. In this at least, India has planned ahead and the government has demonstrated the political will to enact a much-needed but highly contested reform. End Summary.

GOI Opens NPS To The Unorganized Sector

¶2. (SBU) India's Labor Day, May 1, 2009, marked the opening of a pension plan to nearly 400 million Indians not covered by a government or employer plan. On that day, the interim Pension Fund Regulatory and Development Authority (PFRDA) rolled out the "defined contribution" New Pension Scheme (NPS) to private sector companies, self-employed professionals and informal sector workers. Originally envisioned in legislation that was introduced in 2005, the government has been steadily implementing the organizational architecture of the ambitious scheme since 2006 through administrative fiat (see reftels A, B, C). Since the bill's passage remained stuck, Ms. Meena Chaturvedi, Executive Director of the PRFDA, told Econoffs on May 6 that the government recently took a

legal opinion which determined that "saving for old age does not require" legislation and that the government could move forward with opening the pension plan to the unorganized sector.

¶3. (U) The NPS is open to "all Indian citizens" (between the ages of 18-55) including non-resident Indians (other than the government workers who already are a part of the pension schemes), which PFRDA estimates is about 370 million out of India's estimated work force of 450 million (Note: India's labor force is currently growing by about 10 million a year. End note.) Subscribers must contribute a minimum $122 (Rs 6000) each year or $10 monthly, with no maximum, into one of three schemes - predominantly equity, government securities and corporate bonds, with varying degrees of risk. Equity investment is currently capped at 50 percent of the total amount and can be invested only in index-linked funds. The subscriber will have the option to decide how the NPS pension wealth is to be invested in three asset class. If an investor is unable to decide the investment mix, the default option, called auto choice lifecycle fund, will be applied, which will see the investment mix change according to the age of the subscriber. On attaining the retirement age of 60 years, account holders will be required to compulsorily withdraw at least 40 per cent of their pension wealth and the remaining 60 percent can be withdrawn as a lump sum in a phased manner.

Pension Fund Managers to Invest Retirement Funds

¶4. (U) The PFRDA in February appointed six fund managers including State Bank of India, UTI, IDFC, ICICI Prudential Life Insurance, Kotak Mahindra and Reliance Mutual Fund to invest the retirement

funds in different investment options. This marked the entrance of private pension fund managers. The PFRDA has also stated that private firms with foreign direct investment (FDI) up to 26% equity are also eligible to participate, in line with FDI caps in the insurance sector. Executive Director Chaturvedi told Emboffs that the regulator anticipates adding more fund managers over time. The regulator will publish the net asset value of all the funds every year in April, giving subscribers an annual chance to switch among funds, based on performance information. The PFRDA will follow the mark to market method to calculate the final return offered by the fund managers.

Registration through Points of Presence

¶5. (U) The points of presence are the "customer interface" as PFRDA describes it: the physical site where NPS subscribers can go to sign up, make regular deposits, submit changes to their investment options or pension fund managers (PFMs). The points of presence (POP) are then responsible for conducting KYC norms, routing the information and the funds to the appropriate part of the NPS "architecture", for e.g., the subscriber information or changes to the central recordkeeping agency or deposits to the trustee bank. The POPs do not create or sell their own products or services; they simply are transmittal points within the architecture. There are currently 22 approved POPs, which are all banks or financial service firms. Most of the POPs are state-owned banks, but the list also includes Citibank as well as private Indian banks ICICI and Axis. Initially, PoPs are offering NPS at a limited number of branches. However, in the next three months, they are expected to expand to 6000 branches. Savings would then be routed to a Central Recordkeeping Agency, and thereafter managed by the Fund Managers who will charge a very low fee of just 0.009% per year.

¶6. (SBU) Chaturvedi told Emboffs that Indian Post is not/not currently a POP. PFRDA invited it to apply to become one, but the process of becoming a POP is a voluntary application process and Indian Post declined to apply. She thinks it may be because of the requirement for a certain level of computerization to handle all the data transmittal. She indicated that PFRDA had signaled to Indian Post that it could receive some relaxation on the computerization or capital reserves requirement that PFRDA makes of POPs. Press has also reported that the insurance regulator, IRDA, has denied

permission to insurance companies to become POPs upon the invitation of the PFRDA, unless they set up 100% subsidiaries for the purpose. Reportedly, the IRDA is concerned that insurance funds might be mis-channeled into the pension contributions.

Tax Treatment of NPS

¶7. (U) Currently, the NPS provisions follow the EET (exempt-exempt-taxable) system, which means that while contributions and returns to the NPS are exempt, withdrawals attract tax. The PFRDA has argued to the Finance Ministry that the NPS should enjoy a level playing field in terms of tax equality with other financial instruments, such as the Public Provident Fund and the Employees Provident Fund, which enjoy EEE (exempt-exempt-exempt tax free at all stages) status. Chaturvedi noted that the tax liability could only be changed through the budget and was hopeful that the Budget 2009-10 (expected to be announced in July 2009) would give NPS contributions the maximum EEE tax benefits.

A Few Initial Problems

¶8. (SBU) Critics note that the transaction costs under the NPS are the same for all income groups (i.e. an initial annual fee of $7, a levy of 10 rupees (20 cents) per transaction by the Central Recordkeeping Agency and a charge of 20 rupees (40 cents) per transaction from the point of presence), which disproportionately hit lower-income subscribers. In addition, the program requires an annual minimum contribution of Rs 6000 ($122), which also may limit membership. Chaturvedi conceded that, initially, PFRDA expects the

scheme to be most feasible for self-employed workers like shopkeepers or semi-skilled artisans like tailors, rather than lower-skilled day laborers, who often earn just Rs 100 a day. She also speculated that the government may have to subsidize the cost for the very poorest subscribers.

Legislation Still Important

¶9. (SBU) Chaturvedi also told Emboffs that, while the government had been able to implement almost all of the pension reform envisaged in the stalled PFRDA legislation, PFRDA and the government still felt passage of the bill was important. First, it would provide statutory authority to the PFRDA as a regulator (Note: most of the PFRDA's work to date had been in its development role. End note.) In addition, the pension regulatory authority looked to the legislation to authorize the PFRDA to oversee existing, private pension plans currently offered and managed by a few insurance companies.

Comment

¶10. (SBU) Creating the system architecture for handling 30 million current government pensions and opening the system to India's nearly 400-million strong uncovered informal workers is a significant reform achievement for the UPA government, especially given the opposition from the Left. In addition to providing critical old-age support, the expansion of the pension sector and the liberalization of investment options also will help deepen India's capital markets. This growing pension sector will bring more institutional investors into the stock markets, mutual funds, corporate bonds, and from the perspective of the government, a critical market for government securities. Even with its teething problems, the NPS now holds out the first-ever possibility of old age income support to several hundred million Indians, whose earlier choice was more starkly between never stopping work or being dependent on grown children.

BURLEIGH